



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

SMALL BUSINESS/SELF-EMPLOYED DIVISION

November 1, 2006

Dan Bucks, Director  
Montana Department of Revenue  
Mitchell Building  
125 North Roberts  
Helena, Montana 59601-4558

Re: Potential disclosures of federal tax information to other state components

Dear Mr. Bucks:

This will confirm your request for guidance concerning the disclosure of tax data maintained by the Montana Department of Revenue (DOR) to the Montana Legislative Fiscal Division (LFD) and Office of Budget and Program Planning (OBPP).

As background, the DOR receives federal tax information (FTI) for state tax administration purposes pursuant to Internal Revenue Code (IRC) section 6103(d) and an agreement with the Internal Revenue Service. This Code section provides for such disclosures to state agencies, bodies, commissions, or their legal representatives charged with the responsibility for the administration of state tax laws and the disclosed data may be used only for state tax administration purposes. The FTI received by the DOR must be properly safeguarded pursuant to IRC 6103(p)(4). 26 CFR 301.6103(p)(7) – 1T of the Code of Federal Regulations provides for termination or suspension of the disclosure of FTI if an authorized recipient (such as the DOR) allows unauthorized disclosure or inspection of FTI and has not taken corrective actions to prevent the recurrence of an unauthorized inspection or disclosure or does not adequately safeguard FTI received.

We were advised by the DOR that FTI may be commingled with Montana state tax information in a tape to be disclosed to the LFD and OBPP. The IRS position is that in instances where FTI and non-federal tax data are commingled in a manner so that FTI cannot be discerned and segregated from the non-FTI, all information in the file be treated as if it were FTI. We understand that is the case with respect to the tape at issue. The issue of commingled tax data is also addressed in section 5.3 of Publication 1075, Tax Information Security Guidelines for Federal, State, and Local Agencies. Briefly, this section requires that if FTI is recorded on magnetic media with other data, it should be protected as if the information was entirely FTI.

However, we further understand that the DOR is required by state law to provide tax data to the LFD and OBPP for revenue estimating purposes and that neither of these entities is a state agency that qualifies for FTI access pursuant to IRC 6103(d). By state statute, the DOR is to provide an unaltered tape of individual and corporate tax information, stripped of identifiers. Please note that the character of FTI that may be in the file is unchanged, even if individual identifiers are removed (See Church of Scientology of California v. Internal Revenue Service, 484 U.S. 9, 1987). To the degree that state law allows disclosure to these entities for tax administration purposes (e.g., assessing the use of state tax laws and potential revision of such laws), FTI can be disclosed if the information is properly blurred. If unblurred FTI was willfully accessed and disclosed in contravention of IRC requirements, individuals making such disclosures could be subject to the criminal and civil penalty provisions of IRC 7213, 7213A and IRC 7431. These penalty provisions also apply to employees of state audit agencies who receive FTI under IRC 6103(d)(2).

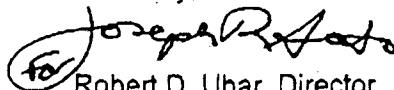
In summary, if the tape to be disclosed to the LFD and OBPP contains commingled FTI that cannot be segregated and removed, then the data must be blurred in order to meet the standards of IRC 6103(b), which excludes from the definition of return information,

"... data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer." With respect to the state law requirement that this information be provided in unaltered form, please be advised that federal law requirements supersede those of state law (See U.S. v. McLeod, 385 F.2d734 (5<sup>th</sup> Cir. 1967).

If you think it might be fruitful to further address these matters, we would be pleased to meet with interested parties, as some of these areas are certainly ripe for discussion.

Should you have any questions, please have a member of your staff contact Sr. Tax Law Specialist Leonard Smigelski at (716) 961-5540.

Sincerely,

A handwritten signature in dark ink, appearing to read "Robert D. Uhar", with a stylized flourish at the end.

Robert D. Uhar, Director  
Office of Governmental Liaison and Disclosure